

Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements

Date: JUL 16 2003

Department of the Treasury
P.O. Box 2508 - Room 7008
Cincinnati, OH 45201

Employer Identification Number:
[REDACTED]

Person to Contact -- I.D. Number:
[REDACTED] - [REDACTED]

Contact Telephone Number:
[REDACTED]

Phone

[REDACTED] FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(4) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

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████████████████████

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Lois G. Lerner

Lois G. Lerner
Director, Exempt Organizations
Rulings and Agreements

Enclosures: 3
Enclosure 1
Form 6018
Publication 892

Enclosure 1

Issues:

You are not operated exclusively for purposes under section 501(c)(4) of the Code for the following reasons:

- a. Your organization does not meet the community standard.
- b. The primary activities of the organization act to further benefit only its members.

Facts:

Your organization was formed as an unincorporated association on [REDACTED], however, the organization has been operating as an unincorporated association since [REDACTED]. The organization filed Form 1120-H for 1999 and succeeding years.

Purpose:

The purpose of your organization as stated in the [REDACTED]

- a. "to maintain a water well or wells and distribution system for common use and benefit of said owners" and
- b. "to share the cost of operation and maintenance of said well or wells and distribution system."

Membership:

Members or "owners" of your organization are defined as "the firm, partnership, corporation, person or persons owning one lot with a residence thereon or one lot without a residence thereon."

The parcel of land is defined as "lots within [REDACTED], a part of the [REDACTED], according to the plat thereof recorded in the office of the [REDACTED], in [REDACTED]. There are [REDACTED] lots within the subdivision."

Activities:

The activities of your organization as stated in your application for exemption include, "Enforcement of covenants to preserve the appearance of development for the benefit of all the residents of the community. Hire local maintenance services as deemed necessary to maintain common areas and well system."

The maintenance responsibilities per the [REDACTED] are as follows:

- "(a) To maintain the pump, tank, pump house, well and distribution system located upon the above described

premises and within the Subdivision known as [REDACTED]

- (b) To provide for the purchase of necessary parts and labor for maintenance of the aforesaid facility.
- (c) To supervise the complete operation and maintenance of said well and distribution system.
- (d) To pay for electricity and all costs and expenses incident to the foregoing.
- (e) To keep a record of all costs and expenses and furnish a copy of the same annually at the annual meeting.
- (f) To perform such other duties as may be directed from time to time by resolutions passed at the annual meeting."

Additional Facts:

In [REDACTED] response to our letter dated [REDACTED], you stated, "There are no common areas, amenities or parks." You also stated, "This is not really a homeowners' association, but a 'well maintenance committee' organized to provide funding for the future maintenance of the water system."

Law:

Section 501(c)(4) of the Code provides, in part, for the exemption from Federal Income Tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 528 of the Code provides, in part, that a homeowners association shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes. For purposes of this section the term "homeowners association" means an organization which is a condominium management association, a residential real estate management association, or a timeshare association if such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property.

Section 501(c)(12) of the Code provides that certain types of organizations such as Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations shall be exempt from Federal income tax, but only if [REDACTED] percent or more of the organization's income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the lessening of the burdens of government.

Section 1.501(c)(4)-1(a)(2)(i) of the Regulations states that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterment and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in paragraph (d)(2) of section 1.501(c)(3)-1 and is not an "action" organization as set forth in paragraph (c)(3) of section 1.501(c)(3)-1.

Section 1.501(c)(12)-1(a) of the Regulations states, in part, that an organization described in section 501(c)(12) must receive at least 85 percent of its income from amounts collected from members for the sole purposes of meeting losses and expenses.

Commissioner v. Lake Forest, Inc., 305 F. 2d 814 (1962), it was held that a corporation that provided nothing on a cooperative basis lacked the necessary requirements. An organization described in section 501(c)(4) of the Code. The court held the operation to be a private self-help enterprise operating for the benefit or convenience of its members by providing services that the members would otherwise have to provide for themselves.

Public Industries, Inc. v. Commissioner, 61 T.C.M. 1626 (1991), the court held a determination as to whether an organization lessens the burdens of Government involves a two-part inquiry as to whether: (1) the activities the organization engages in are ones which a governmental unit considers to be its burden and recognizes the organization as acting on its behalf, and (2) the organization's performance of these activities actually lessens the burden of Government. Columbia Park & Recreation Assn. v. Commissioner, 88 T.C. 1, 21 (1987), affd. without published opinion 838 F.2d 465 (4th Cir. 1988). Petitioner has the burden of proof that respondent's denial is erroneous. Rule 217(c)(2); P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196, 199 (1984). For the following reasons, we hold that petitioner has not satisfied its burden. Petitioner has not shown that any of its anticipated activities are considered to be a burden of government.

Rev. Rul. 65-99, 1965-1 CB 242, held for an organization described in section 501(c)(12) that if for any year the income received from the transaction, together with other nonmember income, causes the organization's income from members for the year to fall below 85 percent, the organization is required to file a corporation income tax return, Form 1120, for that year.

Rev. Rul. 66-148, 1966-1 CB 143, held an organization was formed as a nonprofit corporation for the purpose of establishing and maintaining a system for the storage and distribution of water in order to raise the underground water levels of a community. Membership in the organization is available to any water user in the community who agrees to pay an

assessment based upon the number of gallons of water pumped from the user's private well. Such payments constitute the organization's only source of income. However, the increase in the level of the underground water table which results from the organization's activities benefits all residents of the community whose wells are supplied by the raised water table, regardless of whether they are members and regardless of whether they pay anything to the organization. Memberships and assessments are obtained by the organization on a voluntary basis. By attempting to raise the underground water level, the organization is operating for the benefit of the entire community. Accordingly, the organization is exempt from tax under section 501(c)(4) of the Code.

Rev. Rul. 67-265 1, 1967-2 CB 205, held an association which furnishes light and water to its members on a cooperative basis may qualify for exemption from Federal income taxes as a "like organization" under section 501(c)(12) of the Internal Revenue Code of 1954, provided 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses. The term "like organizations" as used in the statute is limited by the type of organizations specified in the statute. It is applicable only to those mutual or cooperative organizations which are engaged in activities similar in nature to the benevolent life insurance or public utility type of service or business customarily conducted by the specified organizations. See Rev. Rul. 65-201, C.B. 1965-2, 170.

Revenue Ruling 68-18, 1968-1 CB 271, held the purpose of this limitation is to assure that at least 85 percent of an organization's income is derived from its members. Although this limitation is stated in terms of income "collected" from members, the statute is not intended to impose a requirement that an organization's income be computed on the basis of the cash receipts and disbursements method of accounting. In the case of an organization utilizing the accrual method of accounting, 85 percent or more of its income will "consist of amounts collected from members" if 85 percent or more of its income determined under this method is derived from members. Accordingly, the organization must compute the amounts collected from its members on the accrual method for the purpose of the 85 percent limitation of section 501(c)(1) of the Code, provided the organization determines all its income by the same method and uses such method consistently from year to year.

Rev. Rul. 69-280, 1969-1 C.B. 152, held that an organization which provides maintenance to exterior walls and roofs of members who own houses in a development is not exempt as a social welfare organization. The Revenue Ruling stated that organizations operating in such a manner were performing services for its members that would otherwise have to be provided by the members themselves. Thus, it was held that organizations of this sort were being operated primarily for the private benefit of members and any benefits to the community were not sufficient to meet the requirement of the regulation that the organization be operated primarily for the common good and general welfare of the people of the community.

Rev. Rul. 74-17, 1974-1 C.B. 130, held that an organization formed by the unit owners of a condominium housing project to provide for the management, maintenance, and care of the common areas of the project, as defined by State statute, with membership assessments paid by the unit owners does not qualify for exemption under section 501(c)(4) of the Code. The Revenue Ruling states that "the organization's activities are for the private benefit of its members, and cannot be said to be operated exclusively for the promotion of social welfare and accordingly, it does not qualify for exemption under section 501(c)(4) of the Code."

Rev. Rul. 74-99, 1974-1 C.B. 131, held that a homeowners association, to qualify for exemption under section 501(c)(4) of the Code, (1) must serve a "community" which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

Rev. Rul. 80-63, 1980-1 C.B. 116, held that an organization which owned and maintained parking facilities only for its members is operating for the private benefit of its members, and not for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

Rev. Rul. 85-1, 1985-1 CB 177, held the criteria set out in Rev. Rul. 85-2, for determining whether an organization's activities are lessening the burdens of government are: first, whether the governmental unit considers the organization's activities to be its burden; and second, whether these activities actually lessen the burden of the governmental unit. An activity is a burden of the government if there is an objective manifestation by the governmental unit that it considers the activities of the organization to be its burden. The interrelationship between the governmental unit and the organization may provide evidence that the governmental unit considers the activity to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all of the relevant facts and circumstances.

Rev. Rul. 85-2, 1985-1 CB 178, held to make a determination of whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are activities that a governmental unit considers to be its burdens, and whether such activities actually "lessen" such governmental burden. To determine whether an activity is a burden of government, the question to be answered is whether there is an objective manifestation by the government that it considers such activity to be part of its burden. The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also not sufficient to establish that the organization is lessening the burdens of government. The interrelationship between the

organization and the government may provide evidence that the government considers the organization's activities to be its burden. To determine whether the organization is actually lessening the burdens of government, all of the relevant facts and circumstances must be considered.

Application of Law:

Section 501(c)(4) of the Code provides, in part, for the exemption from Federal Income Tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

To satisfy the requirements of this section, the organization must demonstrate that it is both operated for the common good of the community and it does not operate for the private benefit of the members.

Revenue Ruling 74-99, 1974-1 C.B. 131, sets forth criteria for determining what is a "community." The Revenue Ruling provides that a community within the meaning of section 501(c)(4) of the Code and the Regulations is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein, and that it must not conduct activities directed to the exterior maintenance of private residences and the common areas or facilities.

The statements you have submitted demonstrate that your organization does not meet the community requirements set forth in Rev. Rul. 74-99. You stated, "There are no common areas, amenities or parks." You also stated, "This is not really a homeowners' association, but a 'well maintenance committee' organized to provide funding for the future maintenance of the water system."

There is much precedent for denial of exemption for organizations that operate primarily for the private benefit of the members. Rev. Rul. 80-63, 1980-1 C.B. 116, held that an organization which owned and maintained parking facilities only for its members is operating for the private benefit of its members, and not for the promotion of social welfare within the meaning of section 501(c)(4) of the Code. Rev. Rul. 69-280, 1969-1 C.B. 152, held that operating in such a manner were performing services for its members that would otherwise have to be provided by the members themselves. Thus, it was held that organizations of this sort were being operated primarily for the private benefit of members and any benefits to the community were not sufficient to meet the requirement of the regulation that the organization be operated primarily for the common good and general welfare of the people of the community. Rev. Rul. 74-17, 1974-1 C.B. 130, held that since the organization's activities are for the private benefit of its members, it cannot be said to be operated exclusively for the promotion of social welfare and accordingly, it does not qualify for exemption under section 501(c)(4) of the Code. In Commissioner v. Lake Forest, Inc., 305 F. 2d 814 (1962), the court held the operation to be a private self-help enterprise operating for the benefit or convenience of

its members by providing services that the members would otherwise have to provide for themselves.

To contrast the above-mentioned examples, Rev. Rul. 66-148, 1966-1 CB 143, held an organization that was formed as a nonprofit corporation for the purpose of establishing and maintaining a system for the storage and distribution of water in order to raise the underground water levels of a community was exempt under section 501(c)(4) of the Code. The organization was found to be exempt because the community benefits of raising the water table level out weighed the private benefits of the water distribution. Like your organization, the organization maintained a water distribution. However, the organization provides a benefit to the community as a whole, and therefore, qualified for exemption. Your organization does not provide any benefit to the community, and in turn would not qualify for exemption.

Your organization has not provided any evidence that it any benefit to the community, and therefore, would be more similar to the organizations in Revenue Rulings 80-63, 80-63, and 74-17, and case Commission v. Lake Forest, Inc. All of these organizations were denied exemption.

Additionally, the Service has considered whether your organization qualifies for exemption under section 501(c)(12) of the Code. Section 501(c)(12) of the Code provides that certain types of organizations shall be exempt from Federal income tax, but only if 85 percent or more of the organization's income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Rev. Rul. 67-265 1, 1967-2 CB 205, held Furnishing light and water is a type of public utility service similar in nature to that provided by the specified organizations. Therefore, this organization may be exempt from Federal income tax as a "like organization" under section 501(c)(12) of the Code. The activities in Revenue Ruling 67-265 are similar to those of your organization.

However, the Code has an 85 percent income limitation. It is emphasized in Rev. Rul. 67-265 1, 1967-2 CB 205, which states "provided 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses." Two other Revenue Rulings reiterate the 85 percent limitation. Rev. Rul. 65-99, 1965-1 CB 242, held for an organization described in section 501(c)(12) that if for any year the income received from the transaction, together with other nonmember income, causes the organization's income from members for the year to fall below 85 percent, the organization is required to file a corporation income tax return, Form 1120, for that year. Rev. Rul. 68-18, 1968-1 CB 271, held the purpose of this limitation is to assure that at least 85 percent of an organization's income is derived from its members.

Your organization submitted the following revenue information on the Form 1024 application:

Membership Income	\$[REDACTED] %	\$[REDACTED] %	\$[REDACTED] %
Interest Income	\$[REDACTED]	\$[REDACTED]	\$[REDACTED]
Total Revenue	\$[REDACTED]	\$[REDACTED]	\$[REDACTED]

For each of the years, the member income is below [REDACTED]; therefore, the organization would not qualify for exemption under section 501(c)(12) of the Code.

Applicant's Position:

Section 1.501(c)(4)-1(a)(2)(i) of the Regulations states that A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in paragraph (d)(2) of section 1.501(c)(3)-1. In other words, if an organization qualifies for exemption under section 501(c)(3), it would qualify under section 501(c)(4).

In your organization response dated January 14, 2003, you stated, "If this organization does not qualify for exemption under 501(c)(4), and truly falls under Section 528, it would seem unfair that a 30% tax (as on Form 1120-H) be levied on income earned by funds set aside strictly for the repair of a water system, when in the case of a government-owned system, this would not be taxed." In your response dated February 17, 2003, you stated, "As pointed out in hcr correspondence, this organization is fulfilling a function that is normally provided by a local government. In this case we are lessening the burdens of government by operating our own water system."

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the lessening of the burdens of government.

Therefore, it is your organization's position that they qualify for exemption under section 501(c)(3), and in turn section 501(c)(4), because they lessen the burdens of government.

Services response to applicant's position:

Rev. Rul. 85-1, 1985-1 CB 177, held the criteria set out in Rev. Rul. 85-2, for determining whether an organization's activities are lessening the burdens of government are: first, whether the governmental unit considers the organization's activities to be its burden; and second, whether these activities actually lessen the burden of the governmental unit. An activity is a burden of the government if there is an objective

manifestation by the governmental unit that it considers the activities of the organization to be its burden. The interrelationship between the governmental unit and the organization may provide evidence that the governmental unit considers the activity to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all of the relevant facts and circumstances.

Because Revenue Ruling 85-2 establishes a two-part test, it is important to consider whether both criteria are being met by an organization. Meeting one criteria but not the other would not qualify for exemption.

In Prison Industries, Inc. v. Commissioner, the court held that it is the burden of the applicant to prove that its activities are a burden of government. Your organization has not provided any evidence that operating a water system is a function of the local government. Therefore, the organization cannot qualify for exemption by "lessening the burdens of government."

Conclusion:

Based on the facts presented above, we hold that your organization does not meet the requirements for tax exemption under section 501(c)(4) of the Code.

Based on the facts that you have provided in your application for recognition of exemption, we are not able to conclude that you are organized and operated exclusively for public benefit rather than private purposes. Your well system only serves the owners of lots within your subdivision.

Also, based on the facts that you have provided in your application for recognition of exemption, we are unable to conclude that your activity is charitable because it lessens the burdens of government. In the case of "lessening the burdens of government," it is the applicant's responsible to prove the activity is a burden, which you have not done.

Accordingly, you do not qualify for exemption under section 501(c)(4) of the Code because you do not meet the proscriptions in section 1.501(c)(4)-1(a)(2)(i) of the Regulations.

Additionally, based on the facts presented above, we hold that your organization does not meet the requirements for tax exemption under section 501(c)(2) of the Code.

Based on the facts that you have provided in your application for recognition of exemption, we are able to conclude that your organization

does not receive 85 percent of its income from amounts collected from members.

Accordingly, you do not qualify for exemption under section 501(c)(12) of the Code because you do not meet the proscriptions in section 1.501(c)(12)-1(a) of the Regulations.

Note: The organization has been exempt from income taxes under section 528 of the Code by filing Form 1120-H. We recommend your organization continue to file for exemption under section 528 of the Code by filing Form 1120-H.